No. 13225

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

CROFTON DIESEL ENGINE COMPANY, INC., a corporation, and AL LARSON BOAT SHOP, a corporation,

Appellants,

vs.

PUGET SOUND NATIONAL BANK OF TACOMA, a corporation, and ETS-HOKIN & GALVAN,

Appellees.

REPLY BRIEF OF APPELLEE PUGET SOUND NATIONAL BANK OF TACOMA.

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REPLY BRIEF OF APPELLEE PUGET SOUND NATIONAL BANK OF TACOMA.

Counter-Statement of Facts.

On August 18, 1948, the owners of the respondent vessel, the "FLYING CLOUD," executed a mortgage [Libelant's Exhibit 7] on the vessel in favor of appellee Puget Sound National Bank of Tacoma, to secure their note of $25,000.00, which sum was loaned by the bank for the purchase of the vessel. On the same day, a second mortgage [Libelant's Exhibit 8] was executed on the vessel by the owners to the Kazulin-Cole Shipbuilding Corporation for $10,000.00, also as part of the purchase price. The bank's mortgage was first recorded and endorsed on

the vessel's document by the Collector of Customs at Tacoma, and the mortgage of the shipyard was later recorded and endorsed, but both on August 19, 1948. The shipyard's mortgage was subsequently assigned [Libelant's Exhibit 9] to the appellee bank. Under the stipulation made and approved by this Court, the exhibits were not printed in the Apostles, but will be considered by this Court in their original form.

The form and contents of each mortgage are similar. Each mortgage contains the following covenants and conditions which follow the recital of the note:

> "But if default be made in such payments, or in any one of such payments, or if default be made in the prompt and faithful performance of any of the covenants herein contained, or if the said party of the second part shall at any time deem itself in danger of losing said debt, or any part thereof, by delaying collection thereof until the expiration of the time above limited for the payment thereof, or if said parties of the first part shall sell or attempt to sell said property, or any part thereof, or if the same shall be levied upon or taken by virtue of any attachment or execution against said first parties, or if said first parties shall remove, or attempt to remove, said vessel beyond the limits of the United States, *or if said first parties shall suffer and permit said vessel to be run in debt to an amount exceeding in the aggregate the sum of a reasonable sum for strictly current operation and repairs to be kept currently paid within 30 days of date incurred,* or if said first parties shall negligently or wilfully permit

said property to waste, or be damaged or destroyed, *said party of the second part is hereby authorized to take possession* of said goods, chattels, and personal property at any time, wherever found, either before or after the expiration of the time aforesaid, *and to sell* and convey the same, or so much thereof as may be necessary to satisfy the said debt, interest, and reasonable expenses . . .

And it is hereby provided, that it shall be lawful for said first parties, their executors and administrators, to retain possession of the property hereby mortgaged, and at their own expense to use and enjoy the same until said indebtedness shall become due, unless said second party *should at any earlier date declare this mortgage forfeited for nonperformance of any of the covenants herein contained,* or by virtue of any authority hereby conferred on said second party." (Italics added.)

The immediate and proper recording and endorsement of the two mortgages on the ship's document is conceded by appellants.

The vessel then sailed to San Pedro, California.

In October of 1949, a year later, the owners had some work done on the vessel at the yard of appellant Larson. There was no testimony or evidence that Larson did not know that the vessel was mortgaged to appellee when he did this work.

Then, in May of 1950, appellant Crofton did some engine work and gave some supplies. Crofton also well

knew of the appellee's mortgages. To secure his claim, Crofton also took a mortgage at the time he did the work, and this mortgage recites very plainly on its face that it is a "THIRD PREFERRED MORTGAGE." [Crofton's Exhibit "A."]

Later, on or about July 18, 1950, with *three* mortgages now on the vessel, appellant Larson did further work to the value of $2,120.03.

The owners being in default, the appellee, Puget Sound National Bank of Tacoma, filed suit to foreclose their mortgages; the vessel was libeled and sold, and the money paid into the Registry of the Court.

Counter-Statement of Question Involved.

Appellee submits that there is but one question here:

1. Was the District Court correct in holding that the appellee's first and second mortgages did not stipulate that the mortgagee waived the preferred status thereof?

Summary of Argument.

The District Court's decision that the appellee's mortgages did not stipulate to waive their preferred status was a decision of fact, as well as law, and thus there is a strong presumption in favor of the correctness of the District Court's decree.

The District Court decided that appellee's mortgages complied with the Ship Mortgage Act in all respects and particulars.

Appellee's first and second mortgages each state that it is given to secure a promissory note, which is set out, and there is a promise to pay the debt and to "fulfill and perform each and every one of the covenants and conditions herein contained." *Then eight conditions are set forth:* If there is a default in payment; if the mortgage covenants are not performed; if there is danger to mortgagee by delaying collection until expiration of time stated in note; if mortgagor shall sell or attempt to sell; if there is a levy or execution against the vessel; if there is a removal beyond limits of the United States; if the mortgagor runs the vessel in debt beyond a reasonable sum; or if the mortgagor negligently permits the vessel to be damaged or destroyed, then the mortgagee can take possession and sell the vessel to satisfy the mortgage. These provisions were correctly held by the District Court to be conditions of the mortgage, the happening of any one giving the mortgagee the right to accelerate the maturity of the mortgage and foreclose at once.

Both of the suppliers here gave credit knowing that the vessel was under a first and second mortgage to appellee. They were then put on notice as to their junior status. Crofton knew that he was third in line, and so designated his mortgage. Larson relied on the owners personally, he even gave credit after three mortgages were on the vessel. So, neither of the suppliers were deceived or misled as to the first priority of appellee's mortgages.

There is no ambiguity here. The appellants have shown by their own acts at the time they gave credit, that they

knew that they were working after first and second mortgages. Crofton stated that his mortgage (drawn by his present counsel) was a *third* mortgage, and is estopped to deny the validity of appellee's first and second mortgages.

Appellants' fundamental error lies in their argument that to be preferred, a mortgage must prohibit any and all liens under all circumstances. The Ship Mortgage Act sets forth the requirements a mortgage must meet to acquire a preferred status; and a prohibition of liens is not in the Act's requirements, nor has any court so held.

Apppellants are also in error in comparing the rules governing suppliers in charter party cases with the rules where a preferred mortgage is involved, in that:

(a) In charter cases, the one in possession *is presumed to have authority* to incur a lien for supplies;

(b) But, a preferred mortgage *has priority* for supplies, unless the mortgagee stipulates that he waives his preferred status.

That is to say, in charter cases, authority to incur a lien is presumed, unless the contrary is shown, but *priority of the mortgage* is given by statute (unless the mortgagee stipulates to waive the priority) with the supplier's lien coming off second best.

ARGUMENT.

I.

There Is a Strong Presumption of the Correctness of the District Court's Decree.

The District Court found as a fact that the appellee's mortgages did not stipulate that the mortgagee waived the preferred status thereof [A. pp. 77 and 78]. This finding was based on evidence such as the mortgages that were placed into the record, the libelant's interrogatories [A. pp. 59, 61], appellant's answers [A. pp. 63, 65], the oral testimony of William B. Crofton who testified for appellant Crofton. Appellants have failed to bring up the record of the oral testimony, so nothing therein could have been favorable to the position; and either what testimony there was given was unfavorable to appellants, or the failure to testify at all on certain points involved, gave rise to inferences unfavorable to appellants. This Court cannot speculate as to these matters, but must presume that the District Court's finding in that regard was correct. Because of this presumption it cannot be said that the District Court acted in utter disregard of the evidence. (*The Redwood and Sun D'E*, C. C. A. 9th, 73 F. 2d 922; *Donovan v. N. Y. Trap Rock Co.*, 271 Fed. 308; *The Bern*, 261 Fed. 995.)

In other words, we do not have a case here where testimony was entirely by deposition. Live witnesses were called by the appellants. Their testimony, or failure to testify, on the points at issue, was subject to the trial court's scrutiny and judgment. Appellants' counsel claim that there is an ambiguity in appellee's mortgages. Were they ambiguous to the appellants themselves? Did they testify that they believed that they were acquiring lien

superior to those of appellee's mortgages, at the time they did the work? No—and consequently appellants have not brought up their testimony. But the trial court had to determine whether this contention was a matter of lawyer's artifice, or actually an ambiguity to those in the business world. The demeanor of the appellants while testifying, the intelligence they exhibited while being examined, the questions their counsel asked and those upon which he avoided committing his clients—these were elements that the District Court trial judge had to weigh, and which this Court is not in a position to do.

Therefore, in this Court there is a strong presumption that the judgment of the District Court was correct, and if there is evidence to support the District Court's decision, it should be affirmed.

II.

Public Policy Does Not Favor Suppliers Over Preferred Mortgagees of Vessels.

The United States statutes have settled that suppliers of necessaries to vessels have a lien, so we don't have to go back to the Laws of Oleron, etc. Statutes of the United States have created the preferred ship mortgage (46 U. S. C. A. 911, *et seq.*) and these statutes subordinate the supplier's lien to that of the mortgage. (46 U. S. C. A. 935(b).) Public policy as to priorities is incorporated in those statutes, and is not a subject of argument or conjecture.

Appellant Crofton contends that his position is that of a supplier of goods, wares, and services, who asserts a maritime lien therefor. Appellee denies that to be his position in this case. Crofton filed an Intervening Libel

[A. p. 18] to foreclose its Third Preferred Mortgage; the execution of the note by the owners to Crofton, the giving of the Third Mortgage as security, the recording of the mortgage, and subsequent default, are all alleged in detail. The Findings of Fact and Conclusions of Law follow the Libel [A. pp. 79, 84]; as does the Decree [A. p. 90]. The libel contains no cause of action for foreclosure of a maritime lien by Crofton. Appellant Crofton, having tried his case on the theory that he was foreclosing a Third Preferred Mortgage, cannot switch theories on appeal.

The Offer to Stipulate and Acceptance of Offer to Stipulate [A. pp. 67, 71] merely show that the consideration for the note was work and supplies.

Therefore, Crofton's rights in the case and this appeal must depend on its status as a mortgagee. As a mortgagee, by accepting a clearly defined Third Preferred Ship's Mortgage, Crofton is estopped to contest the validity of the first and second mortgages. *The Nan B,* 78 Fed. Supp. 748, involved the foreclosure of a mortgage, alleged to be preferred. The intervener claimed a defect in the said mortgage, and that it had not been verified as required by statute. The Court had this to say of the intervener:

> "Intervener neither altered his position nor was prejudiced in any way by reason of the omission of the words referred to from libelant's mortgage. On the contrary, he acted on the assumption that the validity of the instrument as a preferred mortgage was unquestioned and, accordingly, *recited in his own mortgage that it was a second preferred mortgage* and subject to the lien of libelant's mortgage. It appears well settled that in these circumstances the

junior mortgagee is estopped from contesting the validity of the prior mortgage. *Galveston RR. v. Cowdrey,* 11 Wall. 459, 480, 482, 20 L. Ed. 199; *Sharp v. Hollister,* 65 Colo. 110, 174 P. 301; *Nichols v. Jackson County Bank,* 136 Or. 302, 298 P. 908; *McDonnell v. Burns,* 8 Cir., 83 F. 866; *Avery County Bank v. Smith,* 186 N. C. 635, 120 S. E. 215." (Italics added.)

But even if Crofton be considered the holder of a maritime lien in this case, that will not help him. He has certainly admitted that he gave goods and services to the vessel, well knowing of appellee's two preferred mortgages, and the preferred status of appellee's mortgages will still relegate Crofton to a junior place and only entitle him to be paid after appellee.

The citation by appellant of *The Stjerneborg* case is not in point, since that case involved a *charter* and not a ship's mortgage. Charter party cases are not analogous. Under the statutes of the United States, certain persons in possession under a charter have authority to incur maritime liens, unless such authority is clearly denied to them by the terms of the charter party (46 U. S. C. A. 973). But such a requirement, *i. e.,* denial of authority, is *not* made an element of a preferred ship's mortgage. The statute, 46 U. S. C. A. 922, requires:

(1) The mortgage to be endorsed on the vessel's document;

(2) Duly recorded with the Collector of Customs;

(3) With an affidavit of good faith;

(4) That the "mortgage does not stipulate that the mortgagee waives the preferred status thereof";

(5) The mortgagee to be a citizen of the United States.

The statute then states that any mortgage which complies with the above conditions is a "preferred mortgage"; and 46 U. S. C. A. 953 provides that the preferred mortgage shall have priority over all claims against the vessel, except preferred maritime liens, which are defined in the preceding subsections as a lien arising *prior* to the recording and endorsement of the preferred mortgage, or a lien for damages arising out of tort, wages of stevedore or crew, general average and salvage.

At no place does the Ship Mortgage Act state that a supplier will be prior to a preferred mortgagee, unless the mortgage prohibits creation of any maritime liens by the mortgagor. Appellants can cite no case in support of their argument.

Therefore, it cannot be reasoned that because a supply lien will attach to a vessel ahead of the owner-charterer's rights, unless there is a prohibition of the creation of a maritime lien, a supply lien will also rank ahead of a preferred mortgage, unless the mortgage also contains a prohibition of the creation of a maritime lien by one in possession. The rank of a preferred mortgage is fixed by statute, and the statute says that the preferred mortgage which meets the above five conditions shall have priority over all claims (appellants do not claim that they have a preferred maritime lien as defined by statute (46 U. S. C. A. 953(a)).

III.

The Policy of the Ship Mortgage Act Will Be Promoted by Constructions of the Mortgage so as to Uphold Its Validity Whenever Possible.

While the courts have construed the Ship Mortgage Act of 1920 very strictly when the recording features of the Act were not complied with by the mortgagee, the courts have held that once a mortgage was properly recorded and endorsed on the ship's document, and thus notice given to all, that the purpose and policy of the Act would be promoted by constructions of the mortgage so as to uphold its validity whenever possible.

Thus, the *Morse Dry Dock* case (*Morse Dry Dock & Repair Co. v. The Northern Star,* 46 S. Ct. 589, 271 U. S. 552), relied on by appellants, involved a mortgage that was signed by the mortgagors on one date and recorded. Then some work was done on the vessel by the shipyard. After the work had been done, the mortgage was then endorsed on the ship's document. The shipyard had no knowledge of the execution of the mortgage. Justice Holmes held that the mortgage should have been endorsed to become preferred. Therefore, not being preferred, it was merely a chattel mortgage, over which maritime liens had priority. We have no argument with the case. Obviously, endorsement on a ship's document is essential to give notice to the shipyards, suppliers, etc.

But when the mortgage has been correctly recorded and endorsed, the courts have resolved any doubts in favor of validity. The cases of *Collier Advertising Service v. Hudson Day Line,* 14 Fed. Supp. 335, aff. 93 F. 2d 457, and *The Nan B,* 78 Fed. Supp. 748, are precisely in point.

In *The Nan B* case, the Court said:

"Aside from these considerations and in the absence of authority on the precise point, it is worthy of note that in The Nanking, D. C. Cal. 1923, 292 F. 642, it was held that the provision, prescribed by the same section, that certain facts with reference to the preferred mortgage shall be endorsed upon the mortgaged vessel's document, is merely directory and that a failure to make such an endorsement does not result in a loss of the preferred status accorded such mortgage. Decisions construing similar requirements of statute governing the verification of chattel mortgages are in harmony with the foregoing view and should, upon principles of analogy, be accorded considerable weight. They hold that in the absence of fraud, instruments so common in commercial transactions should be sustained whenever there is an honest and substantial compliance with the statutes *and that criticism directed to matters of artifice rather than to those of substance ought not to prevail. Cf.* American Soda Fountain Company v. Stolzenbach, 75 N. J. L. 721, 68 A. 1078, 16 L. R. A., N. S., 703, 127 Am. St. Rep. 822; Deseret National Bank v. Kidman, *supra;* Puget Sound Pulp and Timber Company v. Clear Lake Cedar Corp., 15 Wash. 2d 707, 132 P. 2d 363, 143 A. L. R. 1249; Wells v. Rutkowski, 6 Cir., Ohio, 69 F. 2d 143.

Finally, the intervenor urges a strict construction because the statute effected a radical departure from traditional admiralty practice in conferring jurisdiction upon admiralty courts to foreclose mortgages

on vessels. The same argument was made, without avail, in urging a like construction of statutes allowing the mortgagor to retain possession of personal property upon executing an affidavit of good faith, upon the ground that such statutes were in derogation of the common law. It is the opinion of the court that the statute here involved should be strictly construed so far as the protection of creditors and lienors from fraud and like acts is concerned, but liberally construed to effectuate the object of the statute to make investments in shipping and ship mortgages more attractive and secure. *The Favorite,* 2 Cir., 120 F. 2d 899.

Accordingly, the court holds that there was a substantial compliance with the statute and that the lien of libelant's mortgage is superior to that of intervenor's." (Italics added.)

In the *Collier* case, Judge Patterson said:

"The object of Congress in enacting the Ship Mortgage Act was to encourage the investment of capital in American shipping, to improve the security of investments by way of mortgage on vessels, and to promote public confidence in such investment. Detroit Trust Co. v. The Thomas Barlum, 293 U. S. 21, 55 S. Ct. 31, 79 L. Ed. 176. That policy would be defeated if an attack based on grounds so inconsequential were to prevail."

Thus, the rule of the *Morse* case should not be applied here, but rather that of the *Collier* and *The Nan B* cases.

IV.

The Ship Mortgage Act Places the Mortgagor and the Suppliers-Repairmen in Different Categories With Different Rights Than the Maritime Lien Act Places the Charterer and the Supplier-Repairmen.

The holder of a preferred ship's mortgage is *not* in the same position as to suppliers-repairmen as an owner who charters his boat. Appellants' argument that they are is false for the very simple reason that the statutes of the United States gives them different rights. Under appellee's Point II, we quoted the statutes and pointed out the fallacy of appellants' argument.

As a matter of practice, a supplier who does business with a vessel need only to ask to see the vessel's document. It must be on board at all times. If the vessel is not under management of the named owners, he can call for the charter. By reading the charter, he can ascertain if there is a prohibition of the creation of maritime liens; if not, he knows he has a lien on the vessel for his supplies, otherwise he looks to the operator alone.

By the same simple practice, the supplier can look at the vessel's document and ascertain if there is a preferred mortgage endorsed thereon. If there is, the amount and due date are shown. He can then call for a certified copy of the mortgage and check to see if the mortgagee has stipulated to waive his preferred status. If there is no stipulation waiving preference, the supplier knows that his lien comes after the mortgage.

V.

The Charter Party Cases Are Not Analogous to the Preferred Mortgage Cases in Considering Maritime Liens.

Appellants seem to base their whole appeal on an attempt to use the rules and reasoning of the charter party cases to this case involving the construction of a preferred ship's mortgage. Appellee, in the preceding paragraph has shown the fallacy of this line of argument.

Language that would indicate to a repairman or supplier that the person ordering the repairs, supplies, or other necessaries, was without authority to bind the vessel therefor, is one thing. Language that would indicate to such a man that the holder of a mortgage on a vessel has stipulated to waive the preferred status of his mortgage is another.

In this case, involving a mortgage, appellants must show that the District Court was clearly in error in deciding that the mortgagee had not stipulated to waive the preferred status of the mortgage. An analysis of charter parties is of no help. For instance, in *The South Coast,* 247 Fed. 84 (aff. 251 U. S. 519), the court held that there was no withdrawal by the owner of the charterer's power to bind the vessel.

In this case, considering all the language of the appellee's mortgages, considering the questioned clause together with the other clauses of the same paragraph of the mortgage, which were also clearly conditions of the mortgage, the District Court had ample and sufficient grounds for its decision in appellee's favor.

VI.

The "Charter Party Rule" Does Not Apply to Preferred Ship's Mortgages.

Under Point VI, appellants restate their previous argument, and cite cases to the effect that the rule in charter party cases, that there must be a withdrawal of power from the charterer to incur a maritime lien, also applies to cases of conditional sales or consignment of a vessel. With this we have no argument.

But we do wish to again point out that the statute governing preferred ship's mortgages is not the same statute as that governing rights under charter parties, conditional sales agreements, consignments, or anything else.

Preferred ship's mortgages are *sui generis,* and to determine rights thereunder, we must look to the statutes creating them, and there alone.

VII.

It Is Not True That the Same Principles by Which Charter Party and Similiar Cases Are Decided Govern Contests Between Maritime Lien Holders and Mortgagors.

In the previous paragraphs, appellee has answered the argument of appellants by pointing out that the principles which govern charter party cases are stated in Sections 971 *et seq.* of 46 United States Code; whereas the principles of governing preferred ship's mortgages are stated in Sections 911-954 of 46 United States Code.

Section 922 of 46 United States Code is the statute which creates the preferred mortgage, and Section 953

states its priority over all subsequent supply or repair liens.

Appellants cite page 451 of Robinson, *Admiralty*. The quote from the text dealt with the *Morse Dry Dock* case, which did *not* involve a valid preferred mortgage. We will just turn the page, and quote from the text, page 452, *to reach the point at issue in this case:*

> *"The order of preference as between liens and mortgage.*
>
> If, however, valid maritime liens arise *and there is also a valid mortgage under the 1920 Act, the latter statute itself provides for the priorities between the liens and the mortgage.* '. . . the term "preferred maritime lien" means (1) a lien arising prior in time to the recording and endorsement . . . etc., or (2) a lien for damages arising out of tort, for wages of a stevedore when employed directly by the owner, operator, master, ship's husband, or agent of the vessel, for wages of the crew of the vessel, for general average, and for salvage, including contract salvage.'
>
> *The effect of this recital is to exclude from preference contract liens, chiefly of the supply and necessary class for which the Federal Lien Acts, already discussed in section 50 et seq., make so much provision.* . . . The contract claims excluded are of such a character that the contractor may ascertain before he acts how the situation stands." (Italics added.)

The citation of the case of *The Henry R. Bregor* (D. C. Md., 1927), 17 F. 2d 423, does not help much here, because the factual situation was different. In that case the District Court found as a fact, from the particular language of the mortgage, considered in context with other language, in the mortgage, that the mortgage had stipu-

lated to waive his priority over supply liens. But in this case, the finding of the District Court that appellee's mortgages did not stipulate away their preferred status, was one based on a reasonable view of all the evidence. What a District Court in Maryland found as a fact when considering one mortgage is of no value when considering whether the District Court here, with a different set of facts, was correct in its decision.

Furthermore, the *Bregor* case did not involve a *condition subsequent* in the mortgage; in the case at bar, a condition subsequent is stated very clearly: If the mortgagors suffer and permit said vessel to be run in debt, the mortgagees are authorized to take possession at once and sell to satisfy the mortgages. Here is a warning to suppliers: Be paid in cash or look to the personal credit of the owners; if you or anyone else place claims against the vessel, which are not paid in 30 days, we will call the mortgages at once regardless of whether the principal note is due; we demand that the mortgagors pay their bills promptly. Surely, that is the antithesis of a stipulation that the mortgagee waives his priority and consents that supply men and repair men shall come ahead of him with their liens.

Appellants' citation of the case of *Eagle Star & British Dominions v. Tadlock* (S. D. Cal., 1938), 22 Fed. Supp. 545, is absolutely not in point. The opinion states in the beginning that the mortgage was *not a preferred mortgage.* The case can be no authority whatsoever when considering the priority of a preferred ship's mortgage. The case holds that the supplier was prior to the mortgage holder, who, not having a preferred mortgage, had only a chattel mortgage, which was outranked by a maritime lien.

VIII.

The District Court Was Correct in Holding That There Was No Ambiguity in Appellee's Mortgages.

By finding as a fact that appellee's mortgages did not waive the preferred status thereof, the District Court impliedly found that there was no ambiguity in appellee's mortgages. The District Court impliedly found as a fact that the provision in the mortgage that "if said first parties shall suffer and permit the vessel to be run into debt to an amount exceeding the aggregate of a reasonable sum for strictly current operation and repairs to be kept currently paid within 30 days of the date incurred . . . second party is hereby authorized to take possession . . . and sell," was a condition of the mortgage; that a condition subsequent was stated, along with seven other conditions in the mortgage; the happening of any one could accelerate the due date and enable the mortgagee to call for immediate payment of its claim. The mortgage must be construed with all the language and provisions being considered.

As to why the mortgagee inserted the clause, a mortgage can, and usually does, contain many conditions and covenants which the mortgagor agrees to fulfill, in addition to paying the debt involved. The purpose of such covenants and conditions is to protect the security of the mortgagee. Where certain property is used in a business by the mortgagor, the mortgagee may look to the business of the mortgagor as well as to the thing mortgaged. If the mortgagor is a commercial fisherman, the mortgagee knows that the usual payment of the mortgage comes from the sale of fish caught. If the mortgagor is a

poor fisherman, or is unable to operate the vessel properly, the first indication thereof will be unpaid supply and repair bills for current operations; under such conditions, the mortgagee may want to be able to call for immediate payment of its debt, and have the power to proceed at once under the mortgage to obtain payment.

As *The Bergen,* 64 F. 2d 877 (C. C. A. 9th), indicates, the mortgagee cannot even by covenant prevent the creation of liens for repairs, supplies and other services. However, where the mortgage contains a condition that such a lien must be paid promptly, the mortgagee has imposed a severe limitation or restriction of the mortgagor. Certainly the inability of the mortgagor to let liens pile up against the vessel, or to be more than 30 days delinquent, is the very opposite of a stipulation that the mortgagee waives its preferred status and consequent priority over such liens.

As to the meaning of the quoted clause, the view taken by the District Court cannot be said to be unreasonable or clearly unsupported by the facts. *The appellants themselves took the same view.* Crofton, in his mortgage prepared by his present counsel, who are now arguing ambiguity, took a "Third Preferred Mortgage" for his work. Certainly it cannot be seriously argued by Crofton now that there was an ambiguity in the appellee's mortgages and that he was misled into thinking that he had a supply lien that ranked prior to the appellee's mortgages. Appellant Larson did the major part of his work after there were three mortgages on the vessel, so he was looking to the owners' credit alone.

Then why this appeal? It seems to us that the whole appeal is based on the belief of appellants' counsel, unsupported by any decisions, that because appellee's mortgages contain no express prohibition of the authority of the mortgagor in possession to incur any liens (App. Br. p. 27), the mortgages are not preferred and liens incurred by the mortgagor in possession are superior to that of the mortgage. In the preceding paragraphs we have shown the fallacy in this argument. A preferred ship's mortgage, being *sui generis* is prior to supply and repair liens because our statutes so provide (Robinson, *Admiralty,* p. 452; *The Bergen,* 64 F. 2d 877). The requirement that mortgages must contain a prohibition against the mortgagor in possession incurring any liens, is a figment of imagination of appellants' counsel.

IX.

The District Court's Decision That the Mortgage Did Not Stipulate to Waive the Preferred Status Thereof Was Reasonable and Supported by the Evidence.

In construing the clause of appellee's mortgages, now in question, the District Court's decision was reasonable and supported by the evidence, in that the clause now questioned must, as is the case when construing any written instrument, be considered in context with the document as a whole. When so examined, it is seen that there are eight conditions clearly set forth in the same

paragraph of the mortgages. The word "if" is used eight times to introduce the *eight conditions* of the mortgage, which are:

(1) If there is default in payment;

(2) If there is not performance of mortgage covenants;

(3) If there is danger to mortgagee by delaying collection until expiration of time stated in note;

(4) If there is an attempt to sell by mortgagor;

(5) If there is a levy or execution on vessel;

(6) If there is a removal of vessel beyond limits;

(7) If the mortgagors run the vessel in debt beyond a reasonable sum;

(8) If the mortgagors negligently or wilfully permit the vessel to waste, be damaged, or be destroyed.

Upon the happening of any one of the above conditions, the mortgagee can call the mortgage due, take possession, and sell to satisfy the mortgage.

As far as the seventh condition is concerned, it places all persons on notice that even if the principal of the note, for which the mortgage is given as security, is not in default, if the mortgagors do not pay their bills promptly in 30 days and thus the enterprise which revolves around the fishing vessel piles up debts, then the mortgagee need not wait but may demand payment at once and have a better chance of getting paid while the mortgagors still have some funds or credit left.

Certainly, the meaning is clear that conditions subsequent are thus stated in the mortgage; and there is *not* stated an authorization permitting debts, nor is there a stipulation that the preferred status of the mortgage is waived as to such debts.

Appellants argue, pages 28 and 29 of brief, that appellee has "permitted said vessel to be run in debt" and that appellee has "allowed the vessel to be run in debt." These statements are misquotations of the mortgage clause, resulting from a lifting out of context of part of a clause.

The mortgage cannot permit or deny the vessel to be subject to liens—any vessel that is mortgaged can have liens placed on it, only they are junior to the mortgage. That is the precise point decided by this Court in *The Bergen,* 64 F. 2d 877. The clause in question here is a condition or limitation on the rights of the mortgagors, to-wit: That if the mortgagors suffer or permit such liens, maturity may be accelerated; *i. e.,* the mortgagors must keep their financial condition in such good shape that their current operating bills are paid within 30 days or else the maturity of the mortgage may be accelerated.

The *Bergen* case, 64 F. 2d 877, is relied on by appellee for the point that the existence of a preferred mortgage on a vessel does not prevent a subsequent lien for repairs or supplies. Secondly, such being the case, the mortgagee can then require that such liens, even though junior, be paid when due or within a certain period of time, on pain of calling the mortgage. That is all that was done by the mortgagee in the case before this Court.

X.

The Balance of Equities Is in Favor of Appellee.

Appellants are seeking a windfall by raising hypertechnical objections to the appellee's mortgages.

At the time Crofton expended his labor and gave his materials to the owners of the "FLYING CLOUD," he fully knew that he was taking a lien therefor that was after appellee's mortgages. He was satisfied to do business on that basis. The District Court's decree places him exactly where he expected to be when he did the work. Wherein is that inequitable?

The same can be said as to appellant Larson. He did work on the vessel when there were two preferred mortgages out, and did the greater part of his work after Crofton placed his third preferred mortgage on the vessel. Larson either knew, or is chargeable with knowledge, of the existence of the preferred mortgages since all three mortgages were recorded and endorsed on the vessel's document. So he was content to rely on the owners' personal credit, and to be after the mortgagees insofar as his lien was concerned. Again, the decree of the District Court gives him exactly what he bargained for. Appellant Larson has not received inequitable treatment.

XI.

There Has Been No Waiver of the Preferred Status of Appellee's Mortgages.

Appellee has covered this point in the preceding paragraphs, especially paragraph IX, and will not repeat the argument here.

XII.

Conclusion.

The District Court's decision that the mortgages of the appellee Puget Sound National Bank of Tacoma contained no stipulation that the appellee waived the preferred status thereof, was a decision that is based on a reasonable interpretation of the mortgages and the evidence in the case, and the appellants have pointed out no evidence that could overthrow the strong presumption in favor of the decree below.

The appellants' argument that a preferred mortgage must prohibit any and all liens in order to prevent a repair or supply lien from attaching and becoming prior to the lien of the mortgagee, does not state correct law. The Ship Mortgage Act gives the preferred mortgage priority over supply-repair liens.

Therefore, appellee's mortgages have priority over appellants' supply-repair liens, and the decree of the District Court should be affirmed.

Respectfully submitted,

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